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Duties and Liability of the Members of the Supervisory Board of Limited Companies in Estonia

The First Cases from the Supreme Court of Estonia

1. Introduction

Every limited company[*1] as a legal person needs special bodies to express its will and carry out its activities.[*2] Though modern company law in all countries provides special bodies to represent and manage the company, the technical structure of these organs varies widely.

In general, two different approaches are recognisable: either the company has a single body with several members, who exercise separate functions, or there are two different bodies with separated functions.[*3] The so-called prototype for the one-tier system is the Anglo-American public limited company. Article 154 of the United Kingdom's Companies Act 2006[*4] stipulates that a private company must have at least one director and a public company must have at least two directors. However, in legal literature it has been argued that, due to flexible legal regulation, British companies can have different types of managing bodies, as the shareholders have the possibility to shape the management system as they like.[*5]

1 In Estonia, similarly to other EU member states, there are two types of limited-liability companies: public limited company (*aktsiaselts*) and private limited company (*osaühing*). See also: M. Vutt. Aktsiaseltsi juhtimismudeli õiguslik reguleerimine ['Legal regulation of the management model of a public limited company'], master's thesis. Tartu 2006, p. 7.

2 About the legal theories of a legal person, see, for example, K. Saare. *Eraõigusliku juriidilise isiku õigussubjektsuse piiritlemine (Abgrenzung der Rechtssubjektivität der Privatrechtlichen Juristischen Person)* [in English: Delimitation of the legal subjectivity of the private legal person], doctoral thesis. Tartu 2004.

3 There are also some countries within Europe that allow public limited companies to choose between the two models (e.g., France and Belgium). M. Vutt. Aktsiaseltsi juhtimismudeli õiguslik reguleerimine ['Legal regulation of the management model of a public limited company], master's thesis. Tartu 2006, pp. 28, 37, 97–98.

4 UK Companies Act 2006. Available at http://www.legislation.gov.uk/ukpga/2006/46/contents.

5 J. Rickford. Fundamentals, developments and trends in British company law – some wider reflections. First part: Overview and the British approach. – *European Company and Financial Law Review* 1 (2004) / 4 (December), p. 405.

The classic examples of a two-tier management model are Germany and the Netherlands. As compared to the one-tier system, the two-tier model is a more recent phenomenon. The concept of a two-tier model is based on the idea of an independent supervision, which means that the control over the management must be carried out by an independent and objective body that must be separated from the everyday management.[*6] The managing bodies of the German public limited company (*Aktiengesellschaft*) are the management board (*Vorstand*) and supervisory board (*Aufsichtsrat*), both of which must be appointed by the founders of the company.[*7] The everyday activities are carried out by the management board, and the task of the supervisory board is to control the activities of the management board in general. German private limited companies (*Gesellschaft mit beschränkter Haftung*) normally have one-tier management structure,[*8] but some special regulations deriving from co-determination rules can make the supervisory board compulsory also for smaller companies.[*9]

An Estonian public limited company, similarly to the German *Aktiengesellschaft*, is managed by two separate bodies and the management model is to a great extent similar to the German one. According to Art. 243 (1) p 7 and Art. 316 of the Estonian Commercial Code[*10], every public limited company must have a supervisory board. According to Art. 189 of the CC, a private limited company shall have a supervisory board if it is provided by the articles of association of the company. As Estonian law does not foresee any co-determination rules, the formation of a supervisory board is voluntary for all private limited companies.[*11] In case shareholders decide to choose the two-tier model, the provisions of the CC concerning the supervisory board of a public company apply correspondingly to the powers and activities of the supervisory board unless otherwise provided by law.

Though Estonian case law has had many examples of claims filed against the members of the management board, Estonian courts have only lately started solving cases where the members of the supervisory board have been sued for damaging the company. The main problem seems to arise from the fact that, although the general principles for the liability are very similar to those for liability of the management board, the functions and tasks of the supervisory board are different and therefore the assumptions about the liability are yet not clear.

The article addresses the core question of the scope of the powers and obligations of the members of an Estonian public limited company's supervisory board. The main research question is: whether and to what extent the relevant Estonian case law takes into account the special features of those obligations. The purpose of the research is to compare Estonian legal regulation and case law to the relevant German regulations. The above-mentioned approach is justified because the German public limited company, as well as its Estonian counterpart, has a two-tier management model.[*12]

6 A.F. Conard. The supervision of corporate management: A comparison of developments in European Community and United States law. – *Michigan Law Review* 82 (1984), pp. 1459–1488.

7 See Art. 30 of the *Aktiengesetz* (AktG; Aktiengesetz vom 6. September 1965 (BGBl. I S. 1089), das durch Artikel 8 des Gesetzes vom 11. April 2017 (BGBl. I S. 802) geändert worden ist. Available at https://www.gesetze-im-internet.de/aktg/).

8 See Art. 52 of the German *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* GmbHG (GmbHG; Gesetz betreffend die Gesellschaften mit beschränkter Haftung in der im Bundesgesetzblatt Teil III, Gliederungsnummer 4123-1, veröffentlichten bereinigten Fassung, das zuletzt durch Artikel 8 des Gesetzes vom 10. Mai 2016 (BGBl. I S. 1142) geändert worden ist).

9 H. Fleischer, W. Goette (Herausg.). Münchener Kommentar zum GmbHG. Verlag C.H. Beck München. 2. Auflage 2016. – Spindler § 52, Rn. 14.

10 Commercial Code. Adopted on 15 February 1995. – RT I 1995, 26/28, 355; RT I 22.06.2016 (in Estonian). Hereinafter 'CC'.

11 Until June 1996, Art. 189 (1) of the CC stipulated that a supervisory board is compulsory for every private limited company that has share capital that exceeds 400,000 kroons, more than 20 shareholders, or more than 100 employees during an accounting year. Until 1 January 2011, a supervisory board was compulsory for every private limited company with share capital of more than 25,000 euros and with fewer than three members of the management board.

12 The use of German law as a source for comparison can also be justified by the view, expressed by the Supreme Court of Estonia, that on many occasions the German legal system serves as a model not only for legal regulations but also, as an example for courts for the interpretation of the relevant law. See CCSCd 3-2-1-145-04, para. 39.

2. Functions and powers of the supervisory board: A comparative view

2.1. General duties of the supervisory board

According to law, the supervisory board of Estonian companies has three major functions: general management of the company, planning of the economic activities of the company, and supervision of the activities of the management board. The general list is regulated in the first sentence of Article 316 of the CC, which stipulates that the supervisory board shall plan the activities of the public limited company, organise the management of the company, and supervise the activities of the management board.

In addition to the above-mentioned generalised description of the duties of the supervisory board, some duties are also specified in other articles of the CC. The duty of the strategic general management[*13] arises from Article 317 of the CC, and as far as the shareholders have not determined the main directions of the activities with their decisions, it is the power of the supervisory board to conduct the general management. According to the first sentence of Art. 317 of the CC, the supervisory board shall give orders to the management board for organisation of the management of the company. The second sentence of the same article stresses the power of the supervisory board to supervise the actions of the management board. According to this provision, all transactions that are beyond the scope of everyday economic activities, as a rule, require the consent of the supervisory board. In general, the consent of the supervisory body is required for conclusion of, above all, transactions that bring about the acquisition or termination of holdings in other companies, the foundation or dissolution of subsidiaries, the acquisition or transfer of an enterprise or the termination of its activities, the transfer or encumbrance of immovable or registered movables, etc. One must note that the list of the transactions that require the consent of the supervisory board is an open one and serves as an example. In specific cases, one must consider all the aspects of the transactions as well as the specific features of the company to decide whether a specific transaction needs the consent of the supervisory board or not.[*14] The Estonian Supreme Court has expressed a view that, in decision on whether a certain transaction needs consent of the supervisory board or not, the extent and the nature of such transactions must be taken into consideration.[*15]

It is also important to note that the supervisory board shall also approve the annual budget of the company unless the power of deciding on such matters is granted to a general meeting by the articles of association (Art. 317 (7)).

However, the meaning and content of the duty to supervise and monitor the actions of the management board is not clearly stipulated in law. Art. 317 (7) CC foresees that the supervisory board has the right to obtain information concerning the activities of the company from the management board and to demand an activity report and preparation of a balance sheet. The law also foresees the right of each member of the supervisory board to demand the submission of reports and information to the supervisory board. An important feature of the powers of the supervisory board has also been described in Estonian legal literature: it has neither the competence nor the possibility of suspending the activities of the management board.[*16]

In addition to that, Art. 317 (6) of the CC stipulates that the supervisory board (as a body) has the right to examine all the documents of the company and to audit the accuracy of accounting, the existence of assets and the conformity of the activities of the company with the law, the articles of association, and resolutions of the general meeting. However, the law does not include the clear standard of supervision. One can conclude that those rights are granted in order to provide the supervisory board and its members the necessary information to fulfil its general duties. The law prescribes neither the exact frequency at which the documents should be checked nor the extent or exact scope of the supervision. This means that the nature of the

13 About the strategic management, see additionally K. Saare, U. Volens, A. Vutt, M. Vutt. *Ühinguõigus I. Kapitaliühingud* ['Company Law I: Limited Companies']. Tallinn: Juura 2015, mn. 1846.

14 According to Art. 317 (2), the articles of association may, however, prescribe that the consent of the supervisory board shall not be required or is required only in the cases specified in the articles. The articles of association may also prescribe other transactions for the conclusion of which the consent of the supervisory board is required. The articles of association may also grant the supervisory board the right to decide on other issues that are not placed within the competence of the management board or the general meeting pursuant to law or the articles of association.

15 CCSCd 3-2-1-9-16, para. 36; CCSCd 3-2-1-26-17, para. 13.

16 K. Saare et al. (Note 13), mn. 1864.

control the supervisory board carries out is different from that of the control carried out by the auditors of the company.

Unlike the management board, being a body that carries out everyday activities and not being obliged to hold meetings, the supervisory board must hold regular meetings. According to Art. 321 (1) of the CC, meetings of a supervisory board shall be held when necessary but not less frequently than once every three months.

As for the supervisory board of a German public limited company, it has traditionally been considered mainly as a controlling body – Art. 111 (1) of the AktG stipulates that a supervisory board must supervise the management board. Under German company law, the supervisory board, similarly to the supervisory board of Estonian limited companies, has several other obligations too. The main rights and duties of the supervisory board are stipulated in Art. 111 of the AktG, but the law also includes many other regulations, which supplement this list. For example, according to Art. 77 (2) of the AktG, the supervisory board has the right to adopt the rules of procedure for the management board (Art. 77 (2) AktG). According to Art. 90 of the AktG, it can demand that the management board should compose the management report. According to Art. 171 of the AktG, the supervisory board controls the annual financial statements, management report, and proposal for the profit distribution.

Unlike Estonian law, the German AktG clearly distinguishes between the duties of the management board and the supervisory board. Art. 111 (4) of the AktG stipulates the prohibition to transfer the powers of the management board to the supervisory board. It has been expressed in German legal literature that the clear distinction and organisational differentiation between the competence to take decisions as regards everyday actions and to supervise those actions derives from the idea that each of the bodies acts independently and is separately responsible for fulfilling its obligations.[*17] However, the articles of association of the company may determine that certain types of transactions may need the consent of the supervisory board. This is considered as a possibility for the supervisory board to participate in managing the company and therefore directly affect the management decisions (in addition to the possibility of advising the management board).[*18] Under German law, it is the supervisory board as a body (a collective entity) that performs the functions and carries the responsibility foreseen in law and not its single members. That means that, in general, it is not possible to delegate any of those obligations to a special committee or a single member of the supervisory board. However, it is possible for some actual monitoring activities to be carried out by special committees of the supervisory board.[*19]

2.2. Standard of supervision

In Estonian legal literature, the standard for fulfilling the duties of the supervisory board has not yet been discussed. In German legal literature, on the other hand, it has been expressed that the law does not require the supervisory board to monitor all the actions of the management board in detail.[*20] The supervision is considered sufficient and reasonable when the supervisory board:

- takes notice of all the reports and information it gets from the management board as well as of the developments and business events that are disclosed by the management board;
- fulfils its obligation to check the annual accounts of a company as well as the reports the management board has presented to the supervisory board about the business relations with affiliated companies;
- is convinced that the management board is properly composed and its members are appropriate for fulfilling their obligations;
- is convinced that the members of the management board co-operate properly and that all the management tools, (i.e., business planning, accounting, and reporting), as well as the company's organisation, meet the requirements;

17 W. Goette, M. Habersack, S. Kalss. Münchener Kommentar zum AktG. Verlag C.H. Beck München. 4. Auflage 2014. – Habersack, AktG § 111 Rn. 96.

18 *Ibid*. Rn. 96.

19 *Ibid*. Rn. 49.

20 W. Hölters (Hrsg). Aktiengesetz. Kommentar. Verlag C.H. Beck München. 2. Auflage 2014. – Hambloch-gesinn/gesinn, Rn 11.

- ensures that the management board fully complies with its reporting obligation pursuant to Art. 90 of the AktG;[*21]
- is able to trace all the indications that might lead the management board to a violation of its duties;
- in any case of significant deviations from the planned development, as well as in the event of any significant deterioration in earnings and assets, or in the case of material deviations as regards those indicators in comparable companies, examines whether those deviations are justified and whether the management board responds adequately.[*22]

Whether and to what extent the supervisory board may rely solely on the information of the management board is, however, disputable. There are different opinions in German legal literature about the question of whether monitoring actions of the supervisory board should be extended to subordinate levels where the management decisions are taken.[*23] Some authors are of the opinion that sufficient monitoring means, in general, that the supervisory board diligently monitors the annual (consolidated) financial statements and the management and auditor's reports and discusses and evaluates the management of the company critically with the management board.[*24] Some authors explain that the supervisory board must, for its part, carry out information-gathering activities to examine the management's actions. However, it has been stressed that the supervisory board is obliged to investigate the management's actions only if the management reports are unclear, incomplete, or identifiably incorrect or if there are credible indications of misconduct of the members of the management board.[*25] It has also been noted that the supervisory board must adjust the intensity of its monitoring to the situation of the company.[*26] The supervisory board has an obligation to interfere, which means that if it discovers a breach of the management's obligations, it must intervene and at least prompt the management board to act in a proper manner. An individual member of the supervisory board who has the appropriate evidence must ensure that the supervisory board or the responsible person deals with the matter.[*27]

It has been expressed that when the company is in crisis, but also in cases of mergers and acquisitions, the members of the supervisory board must act and take part in decision-making more actively.[*28] In general, the supervisory board is allowed to rely on the information it gets from the management board, but it must ensure the existence of adequate organisation of the reporting system and intensify the monitoring when particular circumstances arise – for example, if there are any indications that the existence of the company is threatened.[*29] After insolvency has become evident, the members of the management board are not allowed to make payments on behalf of the company and must file for bankruptcy. Has the supervisory board discovered that the company is insolvent, it must co-act in order to make sure the management board files the bankruptcy application. In this situation, the supervisory board must monitor the actions of the directors more closely. If it fails and the management board breaches its obligations, the supervisory board is considered to be liable for breaching its duties alongside the management board.[*30]

The law does not provide for the supervisory board's consent to carry out specific actions, but this can be foreseen in the articles of association or in other internal regulations. It has been expressed in legal literature that all transactions that are considered particularly important still need the supervisory board's approval.[*31]

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21 Art. 90 of AktG stipulates the list of different reports the management board is obliged to present to the supervisory board. They include e.g reports about the intended business policy of the company, fundamental questions of business planning (in particular financial, investment and personnel planning), profitability of the company (in particular the profitability of its equity), the course of business, the situation of the company as a whole, and transactions which can be of considerable importance for the profitability or liquidity of the company.

22 W. Hölters (Note 20). – Hambloch-gesinn/gesinn, Rn 11.

23 U. Hüffer, J. Koch. Beck'scher Kurz-Kommentare. Band 53. Aktiengesetz. Verlag C.H. Beck München,12. Auflage 2016. – Koch, § 111, Rn 4.

24 W. Goette, M. Habersack, S. Kalss (Note 17). – Habersack, AktG § 111 Rn 44.

25 W. Hölters (Note 20). – Hambloch-gesinn/gesinn, Rn 11.

26 W. Goette, M. Habersack, S. Kalss (Note 17). – Habersack, AktG § 111 Rn 44.

27 W. Goette, M. Habersack, S. Kalss (Note 17). – Habersack, AktG § 116 Rn. 33.

28 W. Goette, M. Habersack, S. Kalss (Note 17). – Habersack, AktG § 116 Rn 37.

29 U. Hüffer, J. Koch (Note 23). – Hüffer AktG § 116 Rn. 15.

30 BGH: Geltung des Zahlungsverbots ab Eintritt der Insolvenzreife. – NZG 2009, 550. BGH, Urteil vom 16. 3. 2009 - II ZR 280/07 (OLG Dresden).

31 U. Hüffer. Gesellschaftsrecht. 7. Auflage. Verlag C.H. Beck 2007, S 285; U. Hüffer, J. Koch (Note 23). – Hüffer, Koch, § 111, Rn 45.

According to German legal literature, in case an upcoming decision of a supervisory board can be considered unjustifiable and unacceptable, any diligent member of a supervisory board is not only obliged to vote against it but also has an obligation to explicitly reject the decision and point out reservations, depending on the circumstances of the individual case. If the management board acts recognisably unlawfully, every single member of the supervisory board must be active and initiate convocation of the supervisory board's meeting.[*32] It has also been argued that the main problem as regards the standard of supervision is the level of information the supervisory board must have. It cannot be expected that the supervisory board monitors the management board continuously in the sense that it checks all the individual transactions, income and accounting documents.[*33] German case law has expressed the view that diligent supervisory board members are not actually expected to prevent every risky business as risky transactions are part of normal business life.[*34]

2.3. Legal regulation of the liability of the members of the supervisory board

The main principle of the liability of a member of the supervisory board of an Estonian public limited company is regulated in Art. 327 (2) of the CC, and according to this provision the members of the supervisory board who cause damage to the company by violation of their obligations shall be jointly and severally liable for compensation for the damage caused. The law also foresees that a member of the supervisory board is released from liability if he proves that he has performed his obligations with due diligence. When comparing the above-mentioned regulations with the provisions that foresee the liability of the directors, one can notice that those regulations are almost identical. In Estonian legal literature, the liability of the members of the supervisory board has been explained similarly to the liability of the members of the management board.[*35] This raises the question of how one can distinguish the liability of the supervisory board from the liability of the directors and whether it is enough to ascertain that the directors have breached their duties in order to hold the members of the supervisory board liable as well.

The legal provisions on the liability of the members of the supervisory board of a German *Aktiengesellschaft* are very similar to the regulations of the Estonian CC. Art 116 (1) of the AktG stipulates that, as regards the duty of care and the liability of the members of the supervisory board, Art. 93 of the AktG, which regulates the duty of care and the liability of the management board, applies *mutatis mutandis*.[*36] The law emphasises that the members of the supervisory board are, in particular, obliged to maintain confidentiality of confidential reports and confidential consultations. The law also stipulates that the members of the management board are, in particular, obliged to compensate for the damage that arises from unreasonable remuneration.

In German legal literature, it has also been explained that, though the provisions that regulate the liability of the directors are applicable in cases of liability of the members of the supervisory board, there are still lots of differences between them. Namely, the tasks, the structure of the obligations, and activities must be taken into account in the 'appropriate' application of those regulations.[*37]

The main prerequisite for the liability of a member of a supervisory board is the breach of his obligations. German legal literature emphasises that, though the breach of duty is a necessary precondition for the liability, it is not the only one, and in order for a member of the supervisory board to be held liable, the damage must occur to the company and the damage must be caused by the breach of obligations of the member of the supervisory board. Therefore, an individual member of the supervisory board cannot be held liable if the majority of the supervisory board behave in accordance with their duties and take a decision that is fully in accordance

32 M. Henssler. L. Strohn. Gesellschaftsrecht. Beck'sche Kurzkommentare. 3. Auflage. Verlag C. H. Beck, München 2016. – Henssler AktG § 116 Rn. 11.

33 Reichard: Darlegungs- und Beweislast im Schadensersatzprozess gegen Aufsichtsratsmitglied. OLG Stuttgart, Beschluss vom 19.06.2012 – 20 W 1/12, rechtskräftig (LG Tübingen), BeckRS 2012, 14126. – GWR 2012, 491.

34 BGH: Haftung eines Verwaltungsratsmitglieds in einer Massengesellschaft. – NJW 1977, 2312. BGH, Urteil vom 4. 7. 1977 – II ZR 150/75.

35 K. Saare et al. (Note 13), mn. 1886–1890.

36 The only exception is that the regulations about the insurance of the management board members against risks arising from their professional activities do not apply.

37 U. Hüffer, J. Koch (Note 23). – Hüffer, § 116, Rn 1.

with the company's interest.*[38] All the members of the supervisory board must act in accordance with the minimum standard of care, but when an individual member has special knowledge, he is subject to an increased level of care, as far as his speciality is concerned.*[39] In addition to that, a higher level of care is expected from the chairman of the supervisory board, which is often reflected in correspondingly greater remuneration.*[40]

It can be concluded that, though German legal regulation as regards the powers and obligations of the supervisory board is more detailed than Estonian, there is no fundamental difference between German and Estonian laws in that respect. The authors are therefore of the opinion that, in consideration of the essential similarity between the management systems of Estonian and German public limited companies, similar interpretation of the scope of the obligations of the supervisory board members would be justified. It is important to note that Estonian legal practice should definitely avoid setting significantly higher standards when interpreting the scope of those obligations.

3. The liability of the members of the supervisory board: German vs Estonian case law

When one analyses the powers and duties of the members of the supervisory board, a question arises: what might be the specific cases when the members of the supervisory board can be held liable for causing damage to the company? Is it possible that the directors of the company are not liable but the members of the supervisory still are?

German case law knows several examples of situations wherein the members of the supervisory board have been held liable for the damage caused to the company. For example, the liability has followed in cases of the supervisory board's inactivity in a situation in which the management board acted unusually carelessly, in cases of giving consent for an under-value sales agreement on the main real estate of the company although the actual value of the property could have been easily ascertained, etc.*[41]

German case law is also of the opinion that in the case of transactions that are of particular importance to the company because of their scope, the risks associated with them, or their strategic function for the company, each member of the supervisory board must record the relevant facts and form his own judgement. This also includes a regular risk analysis.*[42]

The supervisory board members have also been held liable when suggesting that the management board should conclude a detrimental transaction without any legal or commercial justification. The same has happened when the members of the supervisory board had exercised their duties without having a proper idea about the actions of the company that was acting mainly abroad.*[43]

German case law has also taken a view that a member of a supervisory board who endangers the creditworthiness of the company by publicly making harsh remarks about an intra-company conflict violates his duty of loyalty.*[44]

The foregoing analysis shows that German case law has developed versatile practice in the application of the liability of members of the supervisory board. For Estonian case law, however, the issues related to the liability of the supervisory board are still relatively new.

The Estonian Supreme Court has nevertheless recently made two decisions as regards the liability of the supervisory board members, but the authors of this paper are of the opinion that the standard of diligence and the meaning of 'proper supervision' have still remained unclear.

The two cases had similar starting points: the claim of a bankrupted company was filed against both management and supervisory board members. The insolvency administrator, who was acting on behalf of

38 W. Goette, M. Habersack, S. Kalss (Note 17). – Habersack, AktG § 116 Rn. 29.

39 BGH: Haftung des Vorstands und des Aufsichtsrats einer Aktiengesellschaft. – CCZ 2012, 76. BGH, Urteil vom 20. 9. 2011 – II ZR 234/09.

40 W. Goette, M. Habersack, S. Kalss (Note 17). – Habersack, AktG § 116 Rn. 37.

41 U. Hüffer, J. Koch (Note 23). – Hüffer AktG § 116 Rn. 17.

42 D. Lorenz: Pflicht zur eigenständigen Risikoanalyse für Aufsichtsräte – Piëch. – GWR 2012, 156. OLG Stuttgart, Urteil vom 29.02.2012 – 20 U 3/11 (LG Stuttgart).

43 This decision is, however, considered problematic. See U. Hüffer, J. Koch (Note 23). – Hüffer AktG § 116 Rn. 17.

44 D. Lorenz (Note 42).

the company,[*45] claimed that the members of the management board as well as the supervisory board had breached their obligations and thereby caused damage to the company. In both cases, the main action that was considered as a breach of duty of the directors was transferring either all of the assets of the company or a significant part of it to another person. Such transactions were allegedly concluded without the company getting proper exchange.

In the first of the above-mentioned cases,[*46] the insolvency administrator alleged that the director and three members of the supervisory board had breached their obligations and that this breach had resulted in three kinds of damage: the company lost, firstly, its cash; secondly, the main property; and, thirdly, the turnover. The insolvency administrator claimed that the supervisory board had allegedly appointed a director who later was not diligent enough and that the members of the supervisory board did not fulfil their obligation of proper supervision as they did not check the use of the assets of the company. The county court satisfied the action against all the defendants and was of the opinion that it was the supervisory board's inactivity that had partly caused the damage.[*47] At the appeal court, the action remained satisfied against the members of the management board with regard to the damage caused by the loss of cash and property. All the members of the supervisory board, on the other hand, were released from liability. The district court explained that the functions of management and supervisory boards are different as the management board performs its tasks and carries out daily business under its own responsibility and the supervisory board has no right to interfere. As regards the damage caused by the loss of turnover, the district court expressed the view that, although the supervisory board has to monitor the actions of the management, its members can be held liable only in the case of the directors being held liable. The district court also stressed that there was no causal link between the company's damage and the appointment of the new director.[*48]

The Supreme Court annulled the decision of the district court as regards the claim arising from the damage caused by the loss of turnover and referred the case partially back to the district court for a new hearing. The Supreme Court was of the opinion that the possible liability of the director arising from the loss of turnover should be investigated more thoroughly and the question of whether the members of the supervisory board could be held liable for the same damage should be reviewed as well. The Supreme Court agreed with the district court, however, that, as a rule, the members of the supervisory board can be held liable only in cases wherein the members of the management board have breached their obligations.[*49] Unfortunately, the Supreme Court did not give instructions or interpretations related to the actual standard of duty or the scope of obligations of the supervisory board members. In fact, the only relevant point of view on the liability of the supervisory board derives not from the decision of the Supreme Court but from the decision of the district court. Therefore, although the case could be considered as conceptional, the Supreme Court failed to develop Estonian company law in a field that can be considered fundamentally important for development of uniform judicial practice. One can only conclude that if the management board's behaviour does not cause damage to the company, the liability of the supervisory board is also out of the question, regardless of whether the members of the supervisory board have been acting diligently or not.

In the second case,[*50] the insolvency administrator claimed that the members of the management board had breached their obligations by selling the main property of the company to a third party. The sales agreement stipulated that the purchase price would be paid a year and a half after transfer of the assets. No warranties or pledges were established. The insolvency administrator was of the opinion that such actions were not in accordance with the business judgement rule and that the transaction was economically unjustified. He claimed that approving such a transaction meant that the members of the supervisory board had also violated their duty of care and caused the same damage alongside board members. The administrator also declared that the members of the supervisory board had breached their obligations, as they did not monitor the activities of the management board to a sufficient extent. Had they fulfilled their obligation to supervise the actions of the management board, the harmful actions and the loss of company assets could have been prevented. The members of the supervisory board argued that they could not be held liable for the actions

45 According to Art. 315 (4) and Art. 327 (4), in the case of declaration of bankruptcy of a company, only an insolvency administrator has a right to file a claim on behalf of the company.

46 CCSC 3-2-1-113-16.

47 CCSC 3-2-1-113-16, para. 6.

48 CCSC 3-2-1-113-16, para. 9.

49 CCSC 3-2-1-113-16, para. 25.

50 CCSCd 3-2-1-152-16.

of the management board as they had no knowledge of the allegedly harmful transaction and that the supervisory board has no general duty to control all the actions of the management board.

The courts of the first two instances ascertained that the supervisory board as a body had never taken any decision as regards those questionable transactions. The Supreme Court explained that, as the supervisory board had never passed a resolution approving the harmful transaction, it actually never directly decided to conclude it.*[51] The Supreme Court nevertheless emphasised that individual members of the supervisory board could still have breached their duties if they knew that the management board was about to conclude a harmful transaction but did not take any actions to call a meeting of the supervisory board (either through the chairman or directly).*[52]

The Supreme Court also stressed that the members of the supervisory board could not be held liable only because they were aware of the harmful transaction that the members of the management board had concluded. The Supreme Court annulled the decision of the appeal instance and referred the case back to the district court for a new hearing. The Supreme Court instructed the district court that on the new hearing, it should ascertain whether the defendants had had the possibility of taking steps to prevent the damaging transaction being concluded and that if they had had the possibility of avoiding the damage, they should be held liable for the consequences.*[53]

The Supreme Court justified the annulment of the decision of the court of appeal with the fact that the appeal court allegedly failed to consider whether the defendant as a member of the supervisory board was aware of the harmful nature of the transaction. The Supreme Court also noted that if he had had the above-mentioned knowledge, he should have exercised the supervision more diligently.

In general, this approach can be considered justified, but the authors of the article are of the opinion that the above-mentioned reasoning of the Supreme Court and the instructions given to the court of appeal for a new hearing seem to be contradictory. On the one hand, the Supreme Court explains that no member of a supervisory board can be held liable only on the basis of an accusation that he has not provided enough supervision of the actions of the management board. On the other hand, the Supreme Court orders the court of appeal to ascertain whether the members of the supervisory board could have prevented the harmful actions (meaning whether they had provided enough supervision).

The authors of the article note that in assessment of breach by both management and supervisory board members, the main principle is that one cannot conclude that a director or a member of the supervisory board breached his obligations only because the outcome was negative. Any court decision must include the explanations of those differences, and if the court finds that a director has breached his duties, the court should explain how the defendant should have been acting instead.*[54] The question has a member of a supervisory board fulfilled his obligations or violated them cannot be adequately assessed by looking for an answer to the abstract question of whether the supervision was sufficient. Although the case is still pending, the Supreme Court should have given some guidelines to the district court as regards the application of business judgement rule when establishing the liability of the supervisory board members. When assessing the fulfilment of the obligations and establishing the infringement by the members of the supervisory board, one must compare the standard of action (i.e., what the members of the supervisory board should have done) to the actual steps taken (i.e., what they actually did).*[55]

The authors of the article are of the opinion that 'insufficient supervision' itself is not a breach of duties. The actual breach that should be assessed in discussion of the possibility of holding the supervisory board liable is an improper action taken by the supervisory board, or inactivity when it should have acted instead.

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51 CCSCd 3-2-1-152-16, para. 17.

52 According to Art. 321 (1) of the CC, a meeting of the supervisory board shall be called by the chairman of the supervisory board or by a member of the supervisory board substituting for the chairman.

53 CCSCd 3-2-1-152-16, para. 19.

54 The general obligation of proper reasoning for the court decision derives from Art. 436 (1) of the Estonian Code of Civil Procedure (Code of Civil Procedure, adopted on 20.4.2005. – RT I 2005, 26, 197; RT I, 28.12.2016), which stipulates that a court judgement shall be lawful and reasoned. The requirement of reasoning means that the judicial reasoning must be understandable, traceable, and associated with the circumstances that have been identified by the court in this specific matter. This specific procedural requirement of judicial decisions as a prerogative of a lawful court decision has been several times expressed in Estonian case law: see, for instance, CCSCd 3-2-1-13-17, para. 15; CCSCd 3-2-1-42-16, para. 13-15; CCSCr 3-2-1-70-15, para. 20; CCSCd 3-2-1-129-15, para. 15, etc.

55 The same principle is applicable in assessment of breach of duties of the member of the management board (see CCSCd 3-2-1-129-15, para. 15).

The breach of one's duties can be considered as a 'performance gap', and it can only be ascertained via comparing the actions taken to those that should have been taken. The main principle about the liability of the members of the supervisory board cannot be ascertained significantly differently from that about the liability of the directors.

4. Conclusions

The authors are of the opinion that neither of those two decisions of the Supreme Court as a matter of fact answers to the question, what is the actual liability standard of a member of a supervisory board. Both decisions lack the proper application of the business judgement rule, and this approach contradicts the previous approach the Supreme Court has taken when assessing breach of duties of the directors. It is important to note that the breach of duties by a member of a supervisory board as well as by a director can be established only by comparing the obligation with the actual behaviour of the person in question. The above-mentioned decisions might therefore give the false impression that the fact that a director has breached his obligations means automatically that the members of a supervisory board must have also breached their obligations, as obviously the supervision has not been sufficient. This conclusion is however unjustifiable – the breach of the obligations of the management board cannot be considered as the only prerequisite of the liability of the supervisory board.

The analysis also showed that the powers and obligations of the supervisory board of Estonian and German public limited companies are quite similar and therefore it would be reasonable to take the viewpoints expressed in German legal literature and case law at least as a general example when interpreting Estonian legal regulations. One can therefore conclude that the breach of duties of the supervisory board must be assessed separately, with application of the business judgement rule similarly to that in the situation wherein breach of duties of the directors is assessed. The law does not require the supervisory board to monitor all the actions of the management board in detail, and the standard of supervision depends heavily on the circumstances. In the case of the directors of the company having breached their duties, this might but does not necessarily mean that the members of the supervisory board have breached their duties as well.